

# Moscow Financial Weekly

For the Week Ending September 14, 2001

Treasury Attache's office, US Embassy Moscow

## Highlights This Week

- Banking reform creeps along
- **Weekly Focus:** Salaries in Russia

## Key Economic Indicators

Indicators	Level	% chg 1 week	% chg since Jan. 1
Ruble/\$ (MICEX) UTS	29.4467	0.05	4.56
Monetary Base*	R629.3 bln	1.24	30.40
CPI	NA	0	13.2
International Reserves*	\$37.4 bln	-0.27	32.16
RTS Index (end of week)	192.03	-7.33	34.96
Refinancing rate	25	0	0

\*For week prior

## Economic Developments

Highlighting the shift to domestic demand led growth, **real incomes** were up by 5.4% for the year as of the beginning of August and retail sales were up 10%.

Total net **profitability** of private companies surveyed by Goskomstat (the difference between their consolidated income and loss) was R652.7 billion Jan.-July, 3.7% lower y-o-y. The data excludes the agricultural sector, small businesses, banks, insurance companies and state organizations. This data is not very definitive. While it gives some credence to the idea that real appreciation is cutting into competitiveness and profits, the data could also be the result of commodity price changes or other factors.

## Banking sector

Debate over **banking reform** continues. On September 13, after meeting with CBR Chairman Geraschenko, Deputy Prime Minister Alexey Kudrin said that the GOR and the CBR reached a common understanding on a joint strategy on the banking sector that would be submitted to the government before its cabinet meeting on September 27<sup>th</sup>. It is still unclear whether this document will lay out the parameters for an action plan that could be implemented in the next 6-12 months or will be a conceptual document that only sets the stage for further negotiations among the parties. As we reported last week discussions on concrete proposals for minimum capital standards, deposit insurance and accounting have been taking place. On the other hand, on September 17<sup>th</sup> Kommersant published what is said to be a draft of the new strategy that is fairly vague and presents little that is new compared to the CBR's conceptual paper published at the beginning of

2001. (It is worth noting however that Kommersant has a record of publishing “leaked” documents that prove to be out of date.)

Even if the leaked paper does not represent the latest version, it does indicate some of the features likely to be in the consensus strategy:

- The GOR would refrain from creating new state-owned banks and would assess advisability of maintaining its stakes in existing ones.
- Vnesheconombank would be split into two functions: an external debt servicing agent and a credit organization.
- For Vneshtorgbank, January 1, 2003 is a tentative "preliminary reference date" for CBR divestiture.
- Sberbank divestiture would be put off indefinitely.
- Two new functions could be assigned to ARCO: corporate liquidator and the institutional structure for private deposits insurance.
- International accounting standards will be adopted by January 1, 2004.

In October the CBR will liberalize the procedure for Russian companies getting foreign **loans of up to \$100 million**. Companies will need just to notify the CBR of such loans, but will not need permission as currently required. This should be particularly helpful for small and medium-sized businesses.

The Ministry on Antimonopoly Policy (MAP) has officially forbidden the Moscow City government from giving preference to the **Bank of Moscow** in handling the city's banking business. MAP considers the fact that the Moscow government appoints authorized banks without an open tender to be a violation of the law on protection of competition in financial markets. Moreover, MAP claims that the law does not allow affiliated entities to participate in tenders at all. The Moscow government has a controlling (62.7 %) stake in the Bank of Moscow, which services the bulk of city budget accounts. As a result, the bank is 10-th largest in Russia by assets (R49.6 billion) and 15-th largest by capital (R3.7 billion). MAP ordered the Moscow government to eliminate violations within a month and a half. If it does have to stop using Bank of Moscow it will lose more than 40 % of liabilities (R20.3 billion). Meanwhile, Moscow government is challenging the order in court.

According to Deputy Prime Minister Alexey Kudrin, in October the **CBR will publish its IAS balances** for 1999 and 2000. As a result, country risks may be reassessed and Russia's credit rating raised, Kudrin believes. Because of secrecy surrounding precious metal reserves and other obscurities, CBR's balance sheet can be hard to assess even for the IMF.

According to Chairman of Vneshtorgbank (VTB) Yuri Ponomarev, by the end of this year VTB may buy a 10% stake in **Eurobank** (Paris-based daughter of the CBR in which the latter owns 77.75 %). VTB may also buy a 10-% stake in Moscow Narodny Bank (London-based daughter of the CBR). Eurobank became best known for its role in the FIMCO scandal where, in 1995-1996, CBR used money placed at Eurobank subsidiaries to secretly buy GKO's and manipulate CBR stated reserves. As a result, divestiture of CBR foreign subsidiaries has long been a priority of the IMF. Progress has been slow

however, hampered by the fact that the current CBR law still requires the CBR to hold a 50% in Eurobank and Moscow Narodny. Even if CBR were able to divest its majority stake in these banks, doing so to VTB would represent little more than rearranging the deck chairs as CBR owns 99% of VTB.

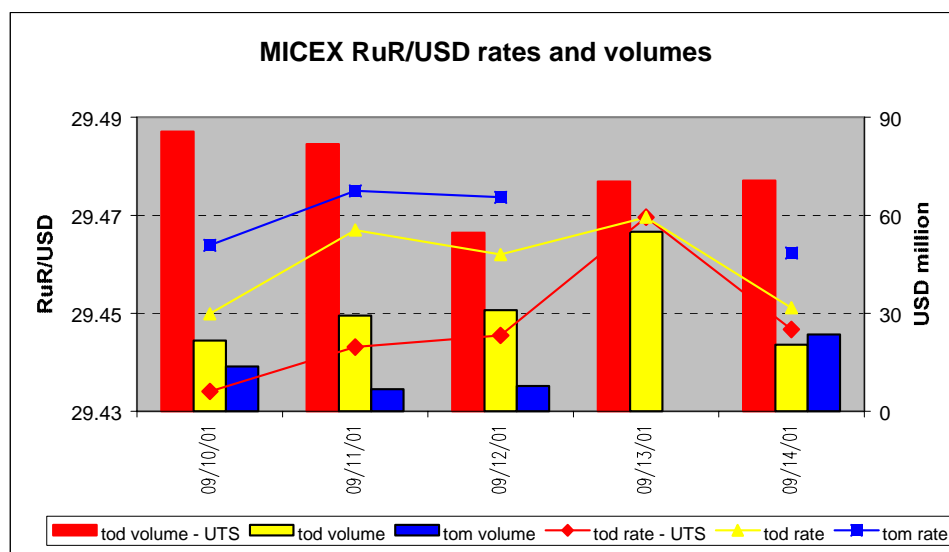
**MDM Bank** is currently completing acquisition of Latvian Trade Bank, 6-th largest by assets in Latvia. MDM does not plan to develop its own business in Latvia; the purpose of the acquisition is to facilitate services MDM is providing to its current clients - large metals and oil traders.

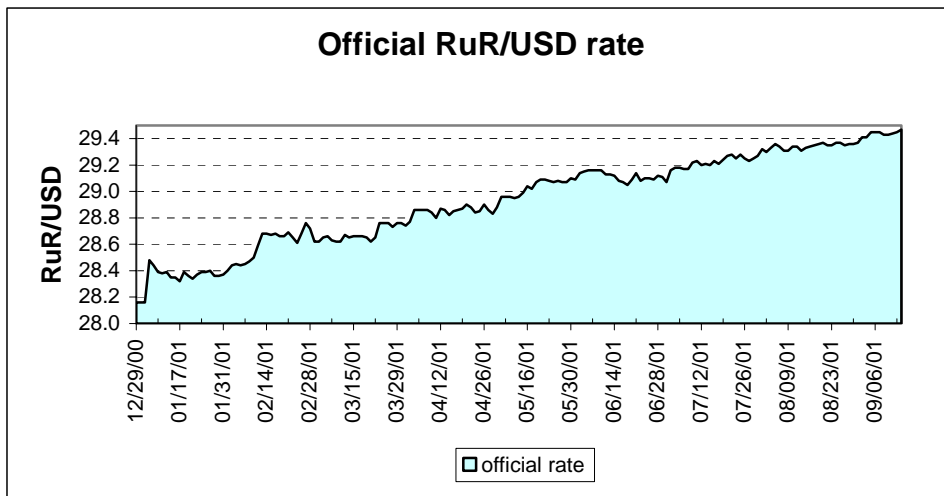
## Financial markets

### Forex Market

The ruble weakened against the dollar Monday and Tuesday. After the news of the attack on U.S. cities some individuals rushed to exchange points to sell their dollars and late Tuesday night and early Wednesday morning the buy rate for cash dollars fell dramatically, as low as R15/\$. The CBR supported the dollar the next day on the market and trading on Wednesday went smoothly, with the dollar actually hitting a record high of R29.4696/\$ in the UTS. Due to a breakdown of its clearing bank, BONY, MICEX had to switch to clearing through Morgan/Chase. On Thursday MICEX had to cancel afternoon trading sessions because statements did not arrive from BONY and regional participants did not have correspondent accounts in Morgan Chase. Instead of regular trading, CBR sold dollars with same day delivery to regional banks at the average UTS price. On Friday MICEX functioned normally, but some participants still did not receive their statements from the U.S. which resulted in ruble strain and ruble firming.

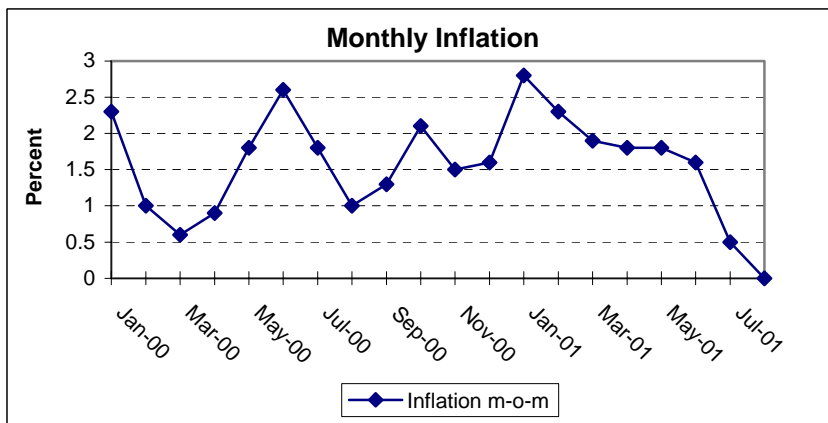
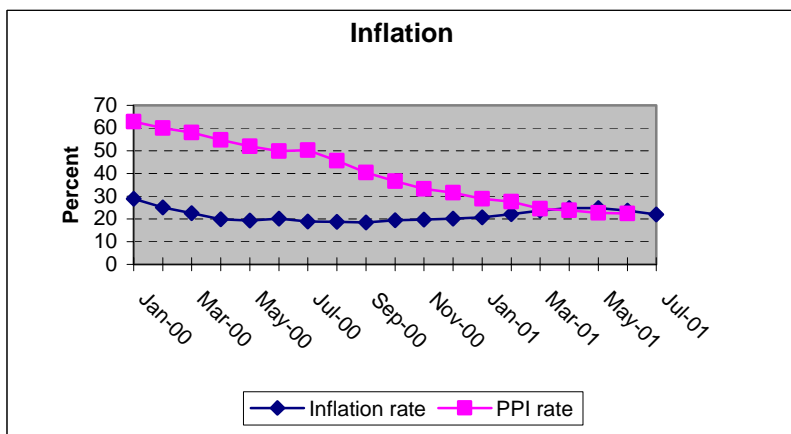
For the week, the ruble weakened 0.05%, closing in the UTS on Friday at 29.4467/\$. MICEX weekly trade volumes were \$359.41 million, \$157.45 million and \$51.72 million for the morning (UTS), afternoon "tod" and "tom" sessions, respectively.





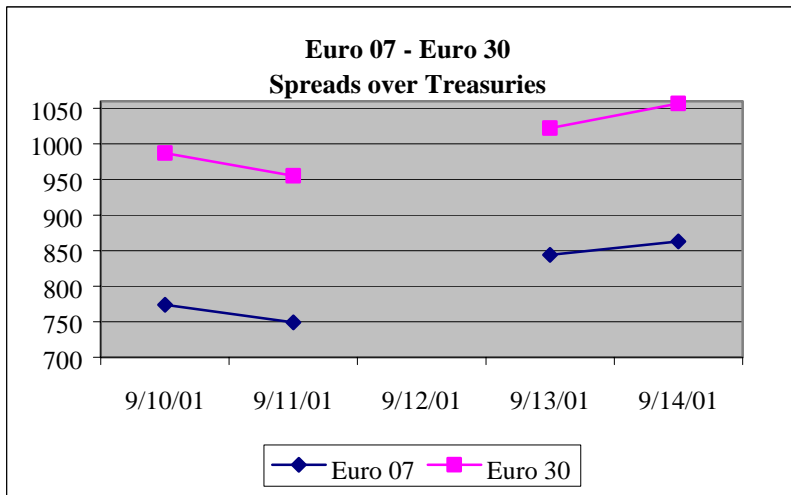
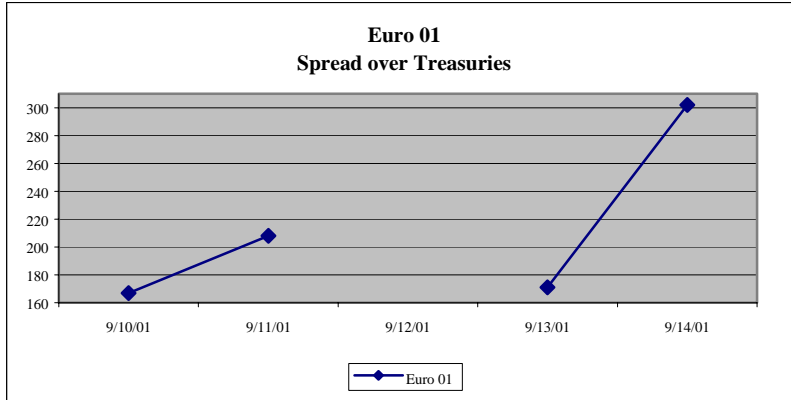
## Prices

During the first 10 days of September prices grew by 0.03%. Inflation was 13.2% during the first 8 months of the year.



## Eurobonds

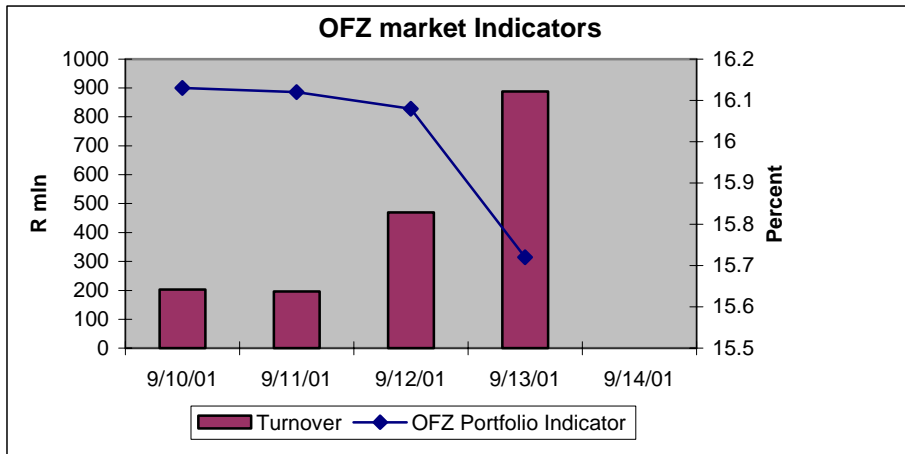
Liquidity on the Eurobond market dried up as a result of the attacks. Prices were down, losing much of the gains in the last three weeks, as investment funds have reduced exposure to emerging markets.



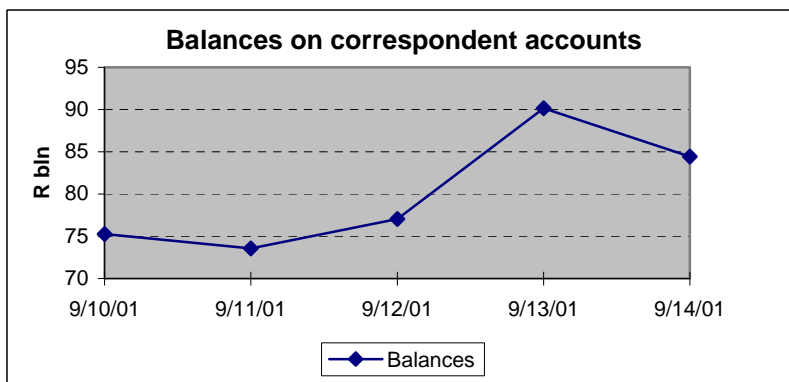
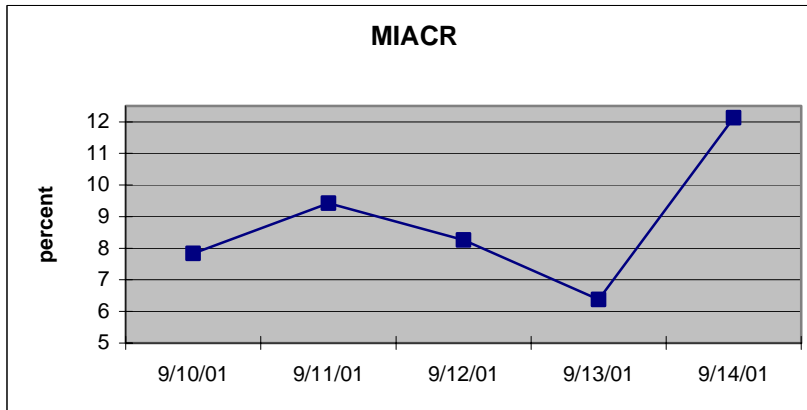
## Interest/Bond Market

### *Bonds/Bills*

The GOR cancelled its latest OFZ auction due to bids of roughly 19% p.a. on 4-year paper, higher yields than expected. This, coupled with major redemptions, pushed prices down. Trade activity was lower than average.

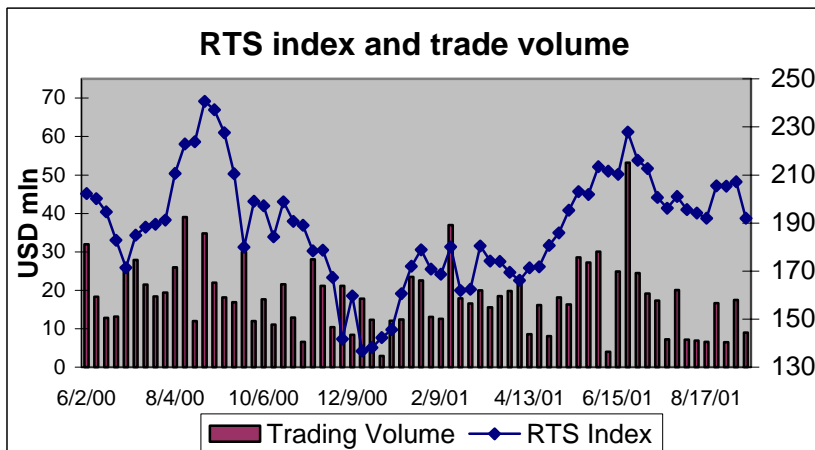
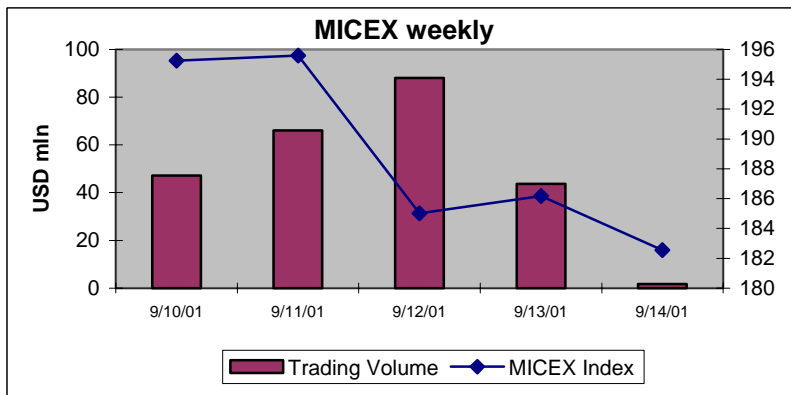
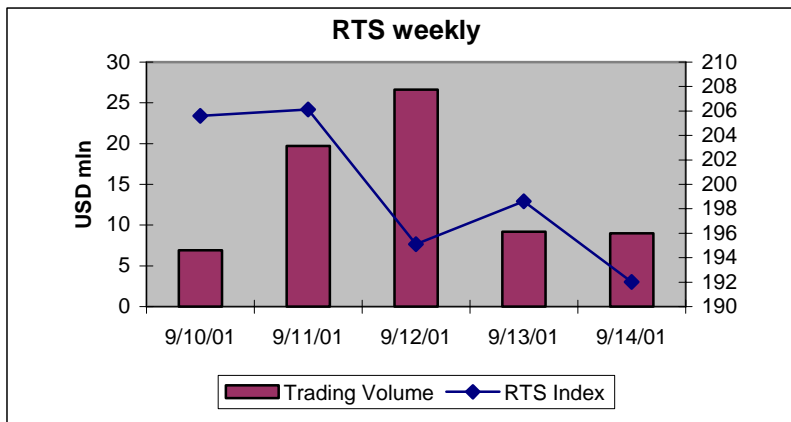


### *Overnight rates*



### Stock Market

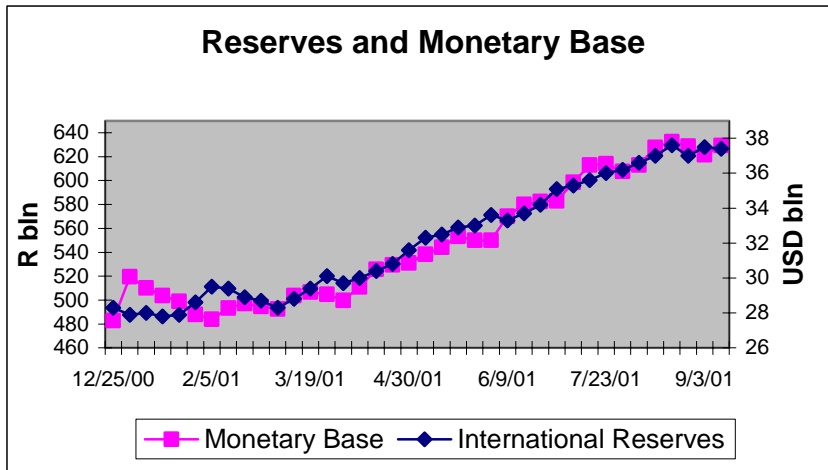
The RTS was up 1.79% on Thursday, recovering slightly from the post-attack fall. However on Friday it continued to fall and lost 3.31% for the day. The index was down by 7.33% for the week in dollar terms. Trade volumes were low as market players preferred to stay on sidelines.



### International Reserves and Monetary Base

International reserves went down the week of Sept 3-7 to \$37.4 billion - 0.27% lower than the week before. This drop was expected following CBR intervention during the first days of September to support the ruble.

After two weeks of sliding monetary base began to grow again and last week it was up by R7.7 billion and reached R629.3 billion.





### Salaries in Russia

It is common knowledge that salaries in Russia are low. It is also generally known that reported salaries aren't always a very good gauge of income. Nevertheless, living in wealthy central Moscow as many foreigners do, it is sometimes hard to internalize how low Russian salaries really are. Another thing that can be quite arresting is looking at relative salaries for different professions. Relative salaries in a market economy should give some sense of what a society values – which in many cases may be quite different than what it professes to value. If this is even close to being the case in Russia, relative salary comparisons paint a very disturbing picture. Perhaps more to the point they demonstrate the distortions inherent in an economy still in transition that is dominated by a narrow sector of export industries.

<b>Average Salaries of Various Professions</b>			
	<u>Rubles/mon</u> <u>th</u>	<u>\$ per</u> <u>month</u>	<u>\$ per year</u>
Oil worker	11,827	402	4,827
Government Minister	10,500	357	4,286
Pilot	10,281	350	4,196
Travel Agent	9,000	306	3,673
Bank employee	8,177	278	3,338
Security guard	6,200	211	2,531
Engineer	5,429	185	2,216
Miner	5,203	177	2,124
Driver	4,115	140	1,680
Scientist	3,670	125	1,498
Construction worker	3,655	124	1,492
Carpenter	2,829	96	1,155
Sales person	2,105	72	859
Doctor	2,042	69	833
Tax inspector (starting)	1,650	56	673
Teacher	1,383	47	564
Farm worker	1,158	39	473
Nurse	1,134	39	463

Source: Russian press (Argumenti i Facti)

### **Do salaries tell us anything ?**

To the extent that salaries represent actual income, they show how far Russia has to go to reach any semblance of European standards of living. To the extent they do not, they are emblematic of how far Russia has to go to rid itself of the distortions of communism. Part of the reason that the economy can work with such low salaries is that people in public service and many other industries receive much of their compensation as benefits

rather than as cash salary. Tax inspectors for example receive subsidized vacations, subsidized or free housing and other benefits that roughly double their take-home pay. Like everyone they also enjoy the benefits of subsidized energy and government healthcare (such as it is). From this perspective low salaries are more a signal of the level of distortion and subsidization in the economy than of living standards. Clearly there is also a question of reporting. Companies have an incentive to underreport salaries to avoid social and other taxes and thus statistics may be inaccurate.

The other obvious form of distortion is corruption. Impossibly low public sector salaries mean that public goods are “privatized” – teachers selling grades, officials charging for meetings, tax inspectors selling exclusions and innumerable other forms of corruption. Still, some of this “corruption” is inevitable given the incentive structures and not necessarily negative. Rather than being a perversion of the system, corruption in many cases is vital to the system’s functioning and necessary for people to be able to survive and do their real work.

### **The effects of reform**

Most of the GOR plan -- monopoly reform, fiscal reform, accounting reform, labor reform, housing reform – is focussed on removing subsidies and market distortions in the economy. To the extent that subsidies become monetized and the associated efficiency gains are translated into higher salaries through more efficient labor markets, salaries will rise disproportionately. Still, this will take a long time and involve serious dislocation.

To address corruption and distortions in the public sector more directly, the GOR is preparing civil service reform, seen as especially important as it underpins other key reforms such as reducing regulation and rationalizing federal regional fiscal relations. Nevertheless civil service reform is not on this fall’s agenda, primarily because of the complexity, potential cost and political sensibility of the issue. Indications so far are that salary reforms will focus on reducing the gap between lower paid civil service workers and higher paid ones, rather than an overall increase in the pay level. But in a system where the Prime Minister’s official salary is less than \$11,000/year and cabinet members’ around \$4,000, this in itself will not accomplish the goals of removing incentives for corruption and attracting talent to government service. More likely, civil service reform will have to come in small steps with a gradual reduction in manpower and corruption and gradual increase in pay levels.

Judicial reform, which is much farther along, will be the first public sector reform to squarely address the link between low salaries and corruption. As part of the plan, average salaries will increase 3-4 fold to roughly \$1000/month – a reasonable sum compared to other professions. While it will be difficult to isolate the effect of better salaries on corruption from improved professional standards and accountability, the effectiveness of judicial reform will provide a good test case for broader public sector reform.

### Questions or Comments?

Please send your questions or comments on this Weekly to [ustreasu@online.ru](mailto:ustreasu@online.ru).

### EXPLANATORY NOTES

**1. EXCHANGE RATES:** SELT - "System of Electronic Lot (currency) trading" -- a computer based OTC-style trading system organized by the Moscow Interbank Currency Exchange (MICEX). "\$-tod" price is the price of the dollar with same day delivery. "\$-tom" is the price of the dollar with delivery on the next day. Minimum lot size for each of the dollar instruments is \$100,000. Average price is quoted as the weighted average of all actual deals entered into the system by various banks.

**2. INTEREST RATES:** Moscow InterBank Actual Credit Rate is calculated as the average-weighted rate on the volume of actual transactions in interbank loans by commercial banks.

**3. STOCK INDICES:** The RTS index is the only official indicator of the Russian Trading System. It is calculated every 30 minutes of the RTS trade session, starting at 12:00. It comprises 60 shares of 35 leading companies. These shares are included in so-called Category "A" listings. The index indicates over-the-counter stock prices. The index represents the ratio of the total market capitalization of the shares of the companies selected for the index to the total market capitalization of the same shares as of the initial date multiplied by the index value as of the initial date (31 December 1997) using a base of 100 beginning September 1, 1995. The ruble-adjusted index is a derivative of the main dollar index, using the same base. The MICEX index is calculated by the stock section of the Moscow Interbank Currency Exchange and is based on the price fluctuations of 17 shares of the MICEX's first and second listings.

**4. INTERNATIONAL RESERVES OF THE RUSSIAN FEDERATION** represent the amount of reserve assets of the Bank of Russia and Finance Ministry. Those reserve assets are comprised of monetary gold, special drawing rights, the reserve position in the IMF and other liquid foreign assets. The latter include short-term deposits in non-resident and resident banks, balances in current accounts, foreign government securities, repo agreements with these securities made with non-residents, and other liquid assets (accrued interest on these assets is not included). Monetary gold is evaluated at a floating rate, revised periodically, but not always reported immediately. Foreign currency assets are converted into U.S. dollars on the basis of the cross rates of foreign currencies to the dollar, calculated using the official rates of the ruble to these foreign currencies, as set by the CBR.

**5. MONETARY BASE** (M1) is comprised of cash and reserves of commercial banks on deposit in the CBR. It is the basic part of the money supply (M2).

**6. LOMBARD CREDITS**, distributed through auctions, are aimed to provide liquidity to the banking sector. These credits are extended to banks on the basis of collateral.